

Government and Corporate Bond Market Development

Overview of Financial Sector Issues and Analysis Workshop

WB/IFC Securities Markets Group

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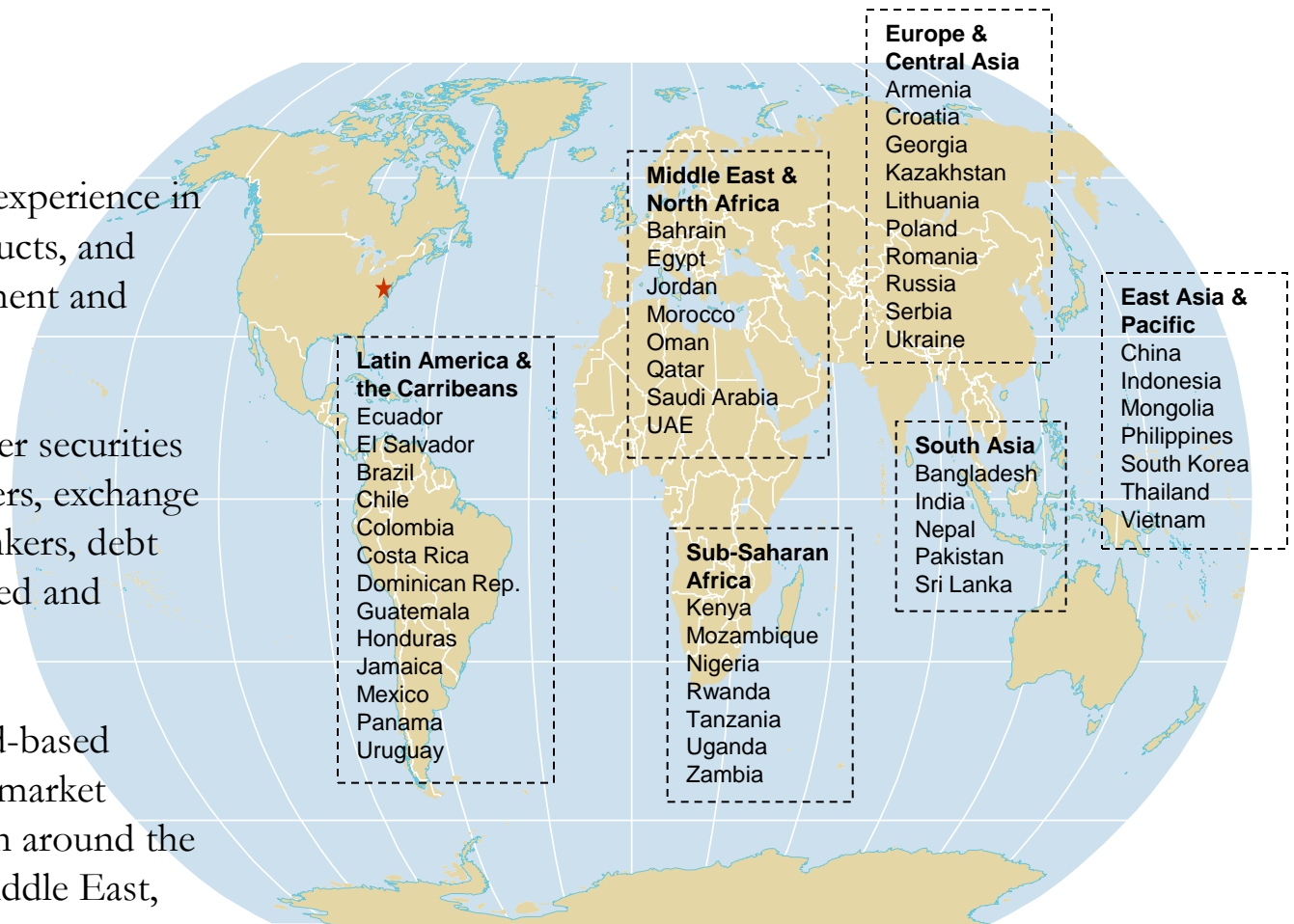
Washington, DC



WB-IFC Securities Market Group (GCMSM)

WBG Global Product Group for local securities market development

- Joint WB/IFC Group
- 30+ years of WB/IFC experience in securities markets, products, and institutions -- development and operations
- Specialists include former securities regulators, central bankers, exchange officials, investment bankers, debt managers from developed and emerging markets
- Team has extensive field-based experience in emerging market countries in every region around the world—Asia, Africa, Middle East, Europe, Latin America

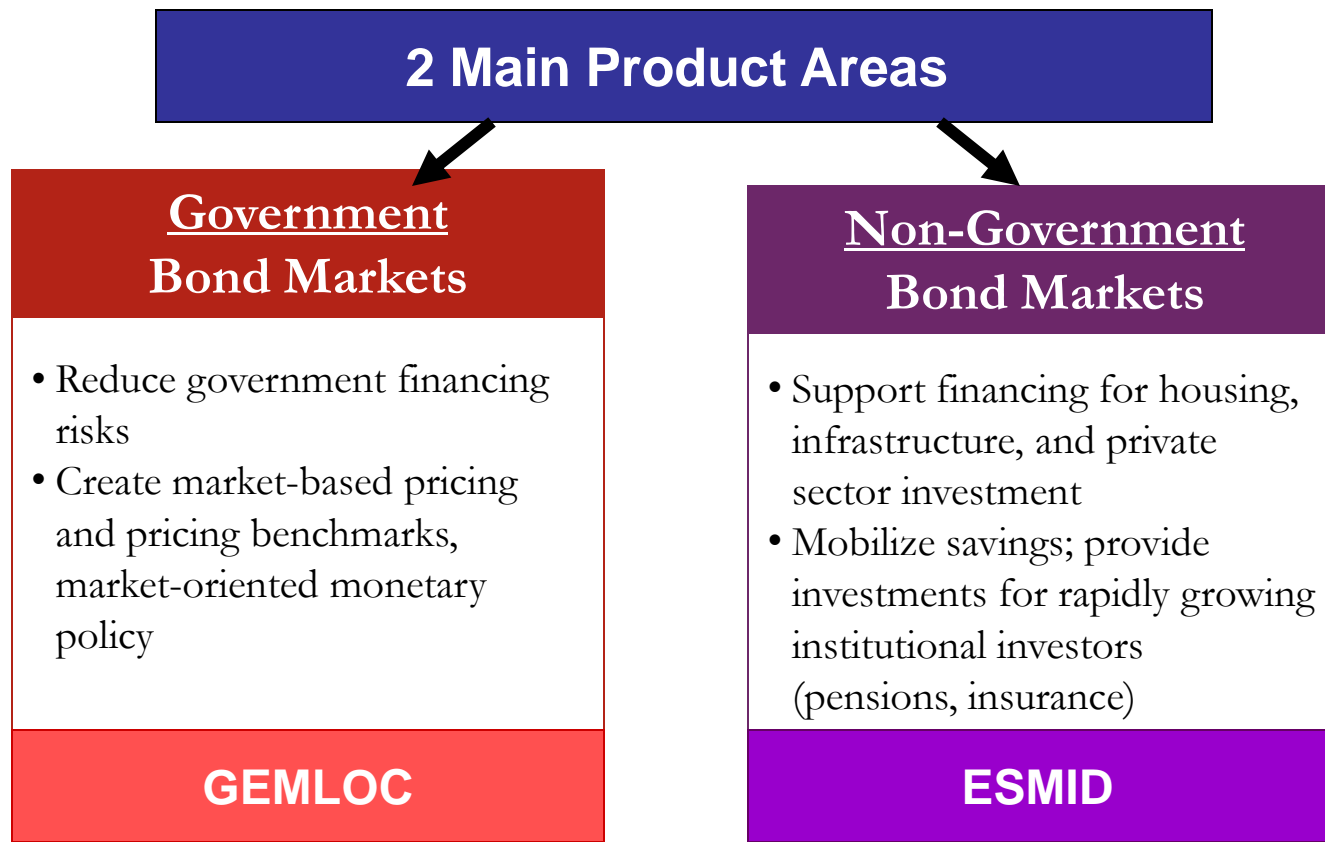


Past and Current Projects

Developing Securities Markets

Develop Domestic Securities Markets, Mainly Debt

- Provide long term, local currency instruments
- Diversify financial systems
- Reduce financing and investment risks
- Create new investment vehicles



Crisis Impact

The global crisis is increasing the demand for domestic securities markets:

- **Need local investors/markets to offset outflow of foreign investors**
- **Need to meet financing requirements to offset banking sector downturn**
- **Need to replace maturing bonds**
- **Need for companies to raise equity to reduce payment outflows**

For our operations:

- **Continue development programs. Shift emphasis as needed**
- **Improve understanding re: ABS instruments**
- **Advise on new regulatory changes**



Government Bond Markets

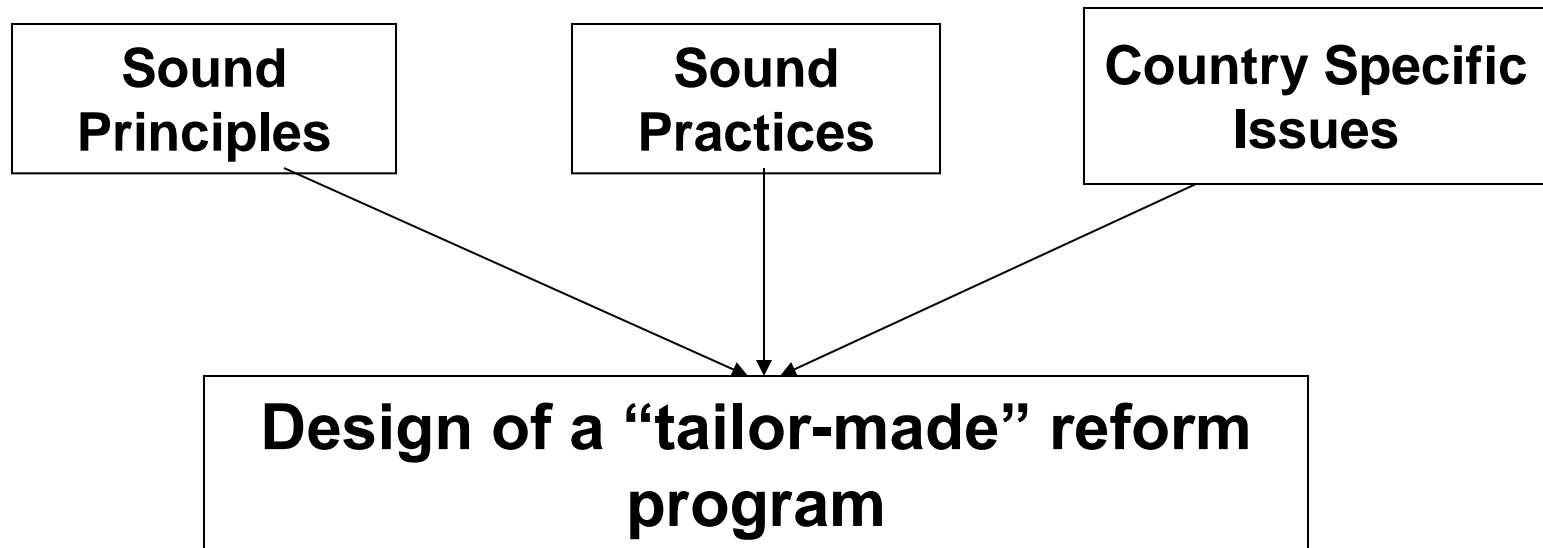
- Scope and Lessons for Reform Implementation
- Crisis Impact and Policy Response
- WB Advisory Services (the Gemloc approach)

Scope: A broad array of issues...

Broad topics	Specific agenda
Macro and Micro interactions and trade-offs	<ul style="list-style-type: none">- Capital controls, international excess liquidity and convertibility- Financial markets taxation structure
Primary Markets	<ul style="list-style-type: none">- Debt management strategy and issuance policy- Placement mechanisms and organization
Money Markets	<ul style="list-style-type: none">- Repo markets- Operational liquidity management
Secondary and Derivatives Markets	<ul style="list-style-type: none">- Exchange and OTC markets- Interactions between markets and development sequence- Valuation schemes
Participants and Investor Base	<ul style="list-style-type: none">- Foreign and local investor base- Strategies for diversification- Prudential regulations
Custody, Clearance, and Settlement	<ul style="list-style-type: none">- Local and International Central Securities Depositories (CSD)- Risk management upgrades
Regulations for Debt Markets	<ul style="list-style-type: none">- Systemic risk and investor protection- Enforcement capabilities

Implementing Reforms: Insights from WB Experience

- Identifying bottlenecks is an issue...



- ...but the major challenges seem to be tailoring programs to specific requirements, sequencing and coordinating their implementation.

Two key challenges for effective implementation

From diagnostics to reform implementation: insights from WB experience (12 country cases)

- High complexity – reform programs affect numerous actors and require creation of sound market infrastructure (trading, settlement, and information systems)
- Extensive interaction between various aspects of debt markets → path dependence
- *Source: Developing the Domestic Government Debt Market: From Diagnostics to Reform Implementation, World Bank 2007.*

- Scope and Lessons for Reform
Implementation
- Crisis Impact and Policy Response
- WB Advisory Services
(the Gemloc approach)

- Shift from credit to liquidity crisis— some EMs hit hard
- Global economic downturn – taking center stage and basically hitting all EMs
- These waves of contagion have affected balance of demand and supply in bond markets

Crisis Contagion: Refinancing Risks

Deleveraging, EM currency depreciation...



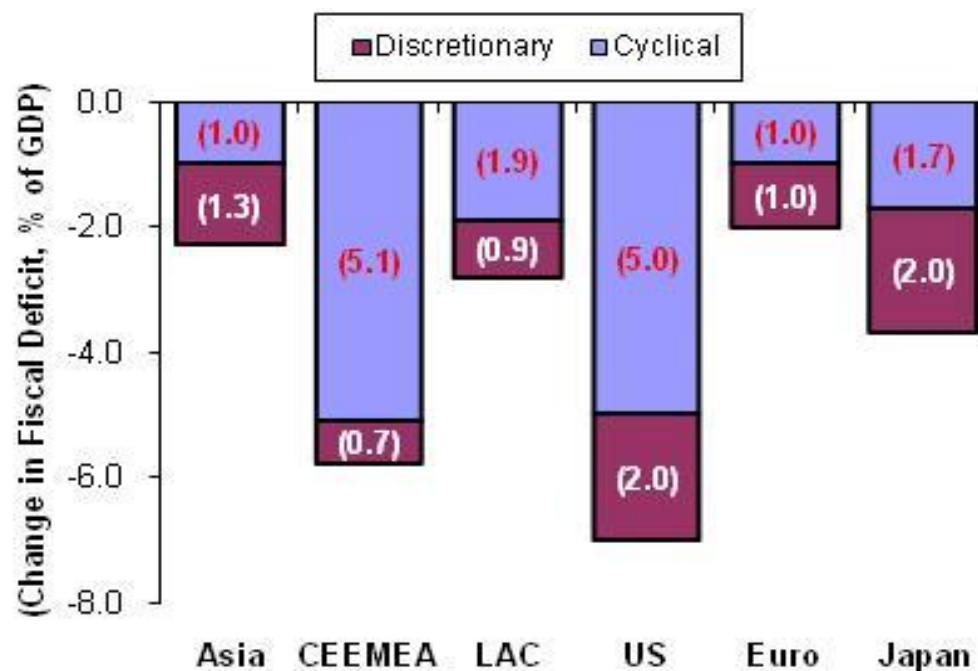
Crisis Contagion: Refinancing Risks (cont.)

...sudden stop of flows and worsening money market conditions are affecting EM issuers access and refinancing risks



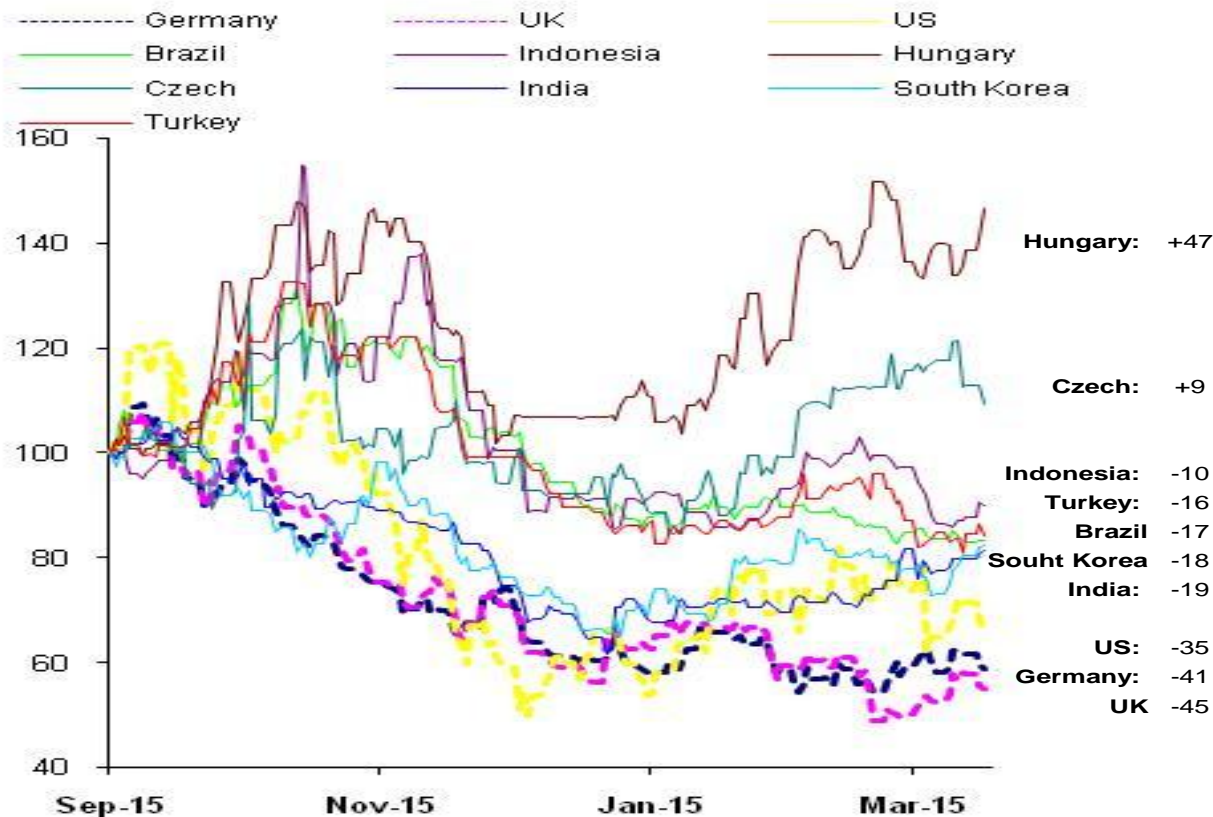
Growing Fiscal Deficits

- Fiscal conditions are deteriorating across developed and EM economies
- Ongoing and expected increase in supply of government bonds – with clear implications to well functioning of bond markets



Impact on local govt. bond yields

- While yields sharply increased in the weeks after the Lehman outbreak, the overall impact in most markets was a reduction.
- Easing monetary cycles and flight to quality



- **Money market**—activities are slow to recover and in need of arrangements to reduce counterparty risk
- **Investor Base**
 - Escalation of buy and hold behavior
 - Shifts in composition of govt securities holders

Crisis Impact: Primary Markets

- **International markets virtually closed to EM issuers**

In domestic markets...

- **Countries were initially pressured to shorten duration of new debt**
- **Several undersubscribed auctions or had to change issuance schedule**
- **Obligations of primary dealers to submit minimum bids and guarantee demand in govt auctions became difficult**

- **Liquidity has dropped substantially**
- **Increased cost of funds, high counterparty risk and difficult access to securities lending hurt capacity to provide bid/ask spreads and guarantee minimum turnover**

- **Develop Repo Markets**
- **Reduce Excessive Supply Pressures by Assessing Funding Alternatives**
- **Improve Issuance Practices**
- **Consider Active Liability Management Practices**
- **Adjust Primary Dealers Programs**
- **Improve Price Dissemination Schemes**

- **Upgrade Clearing and Settlement Infrastructure**
- **Address Other Sources of Transaction Costs**
- **Do Not Forget the Broader Development Agenda**

- **Scope and Lessons for Reform Implementation**
- **Crisis Impact and Policy Response**
- **WB Advisory Services (the Gemloc approach)**

Gemloc Program

- **New World Bank Group initiative combining comparative advantages of WBG and private sector**
- **3 separate but synergistic pillars with 3 commercial partners:**
 - **Investment management (PIMCO)**
 - **Index/investability indicators (Markit + Crisil)**
 - **Advisory services (World Bank)**
- **Creates market-based incentives for policy reforms**
 - **Strengthen market operations**
 - **Increase investability score/GEMX weight**
 - **Attract more foreign/domestic investment**

Gemloc Eligible Countries: Advisory Services

34 countries
currently
eligible

Gemloc Phase 1	Gemloc eligible
Brazil	Argentina
Chile	Costa Rica
China	Croatia
Colombia	Kazakhstan
Egypt	Kenya
Hungary	Lebanon
India	Pakistan
Indonesia	Romania
Malaysia	Sri Lanka
Mexico	Tunisia
Morocco	Ukraine
Nigeria	Uruguay
Peru	Venezuela
Phillipines	Vietnam
Poland	
Russia	
Slovakia	
South Africa	
Thailand	
Turkey	

GEMX Index: Investability Indicators

Category	Indicator	Weight
A. Access		35%
	Access to securities markets	13%
	Access to money markets	8%
	Access to derivative markets	4%
	Effective rate of taxation for fund	10%
B. Liquidity		35%
	Turnover ratio	9%
	Bid-Ask Spread	11%
	Benchmark yield curve	2.5%
	Centralized bond pricing	2.5%
	Institutional investor base	10%
C. Infrastructure		30%
	Regulatory quality	10%
	Creditor rights	5%
	Asset servicing	7.5%
	Clearing and settlement	5%
	Safekeeping safety/soundness	2.5%

Selected Advisory Services Operations

Country Specific Programs

- Egypt, Nigeria
- Add'l to follow

Peer Group Dialogue

- March 31st, first peer group dialogue on crisis challenges in the top emerging bond markets. 9 countries. Via teleconference.
- More peer groups planned

KM Products

- Gemloc survey on development obstacles (22 countries)
- Research papers, policy notes
- Websites: Gemloc advisory services, Peer Group



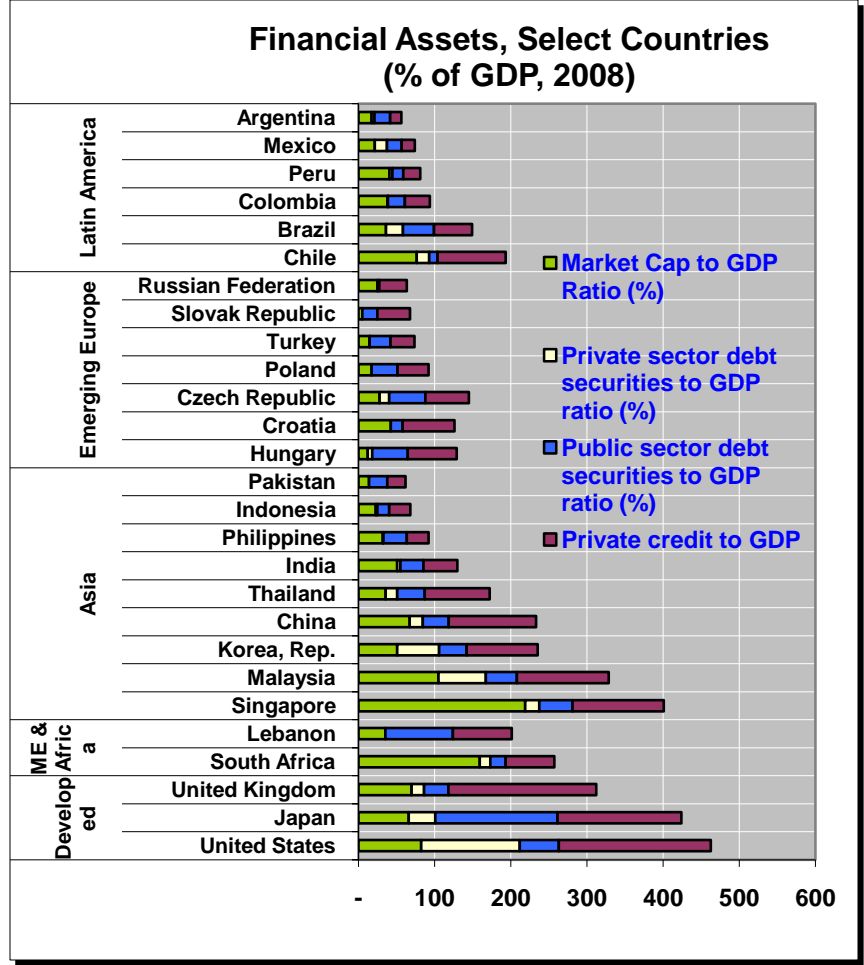
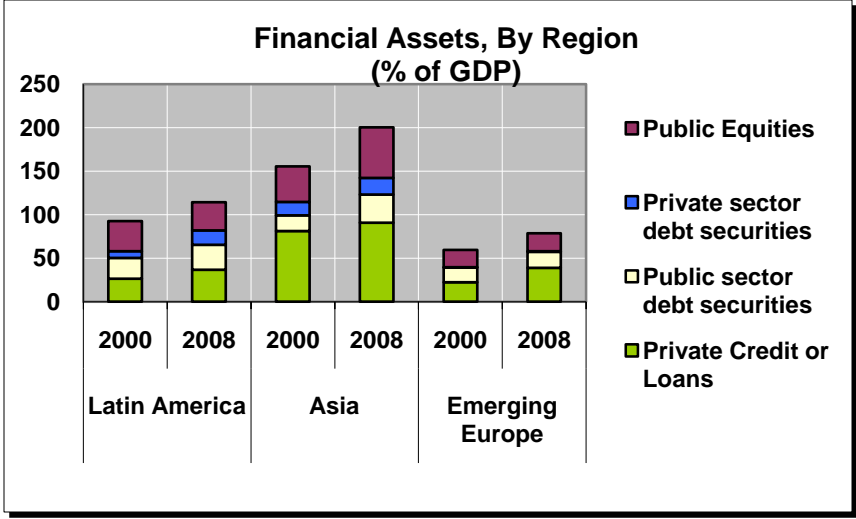
Non-Government Bond Markets

Growing Market Demand

- **Finance housing, infrastructure, capital investment**
- **Provide investments for rapidly growing institutions (pension funds, insurance companies)**
- **Support economic growth with stability**
- **Address crisis demands**

Small Role of Domestic Bond Markets

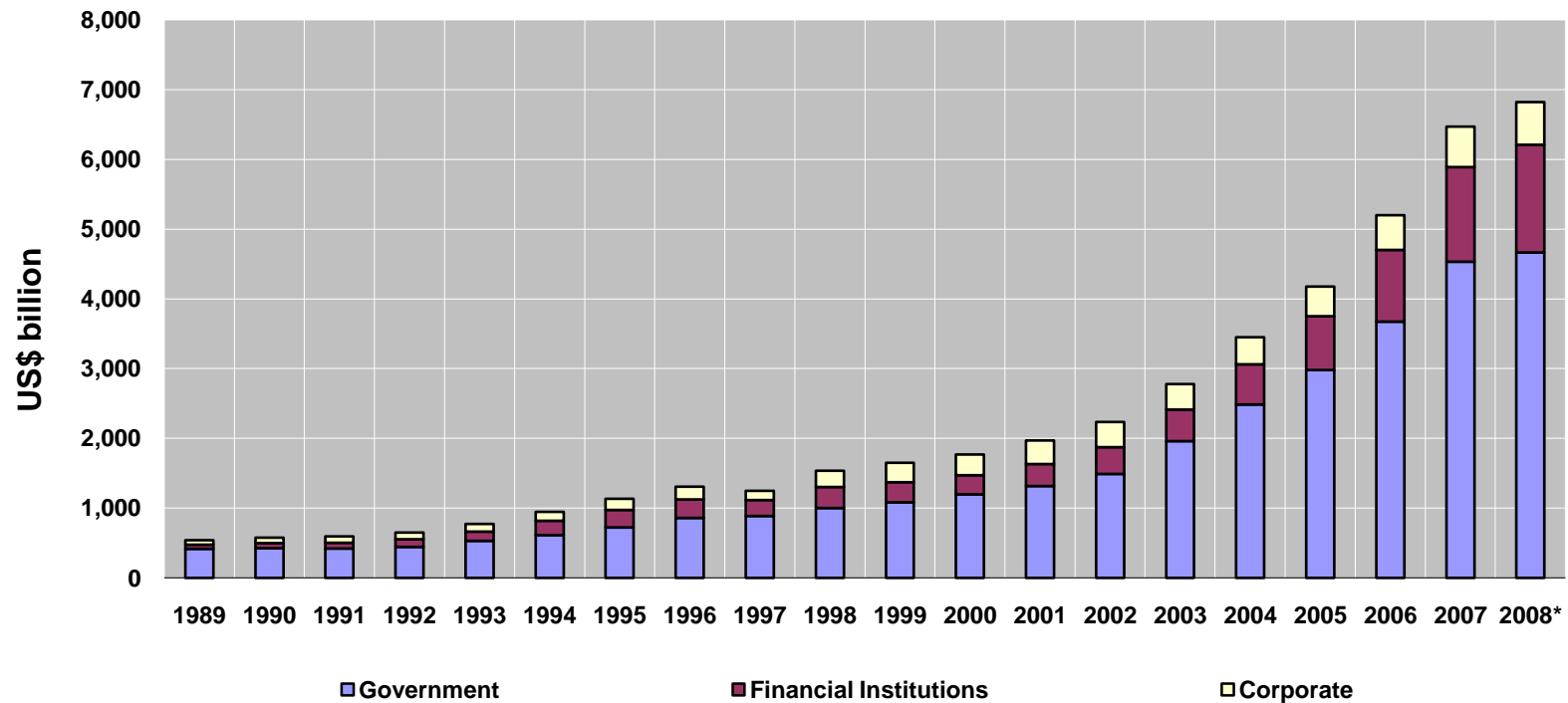
Financial assets are dominated by bank loans and public equities



Note: 1: Latin America: Argentina, Brazil, Chile, Colombia, Mexico, Peru.
 Asia: China, India, Indonesia, Korea, Malaysia, Pakistan, Philippines, Thailand.
 Emerging Europe: Croatia, Czech Republic, Hungary, Poland, Russian Federation, Slovak Republic, Turkey.
 2. GDP : Czech Republic, Indonesia, Korea, Singapore (2007).
 3. Private and public debt securities (end of Sep. 2008).
 4. Market cap: Singapore (2007).
 5. Private Credit: Philippines(2007); Chile , Pakistan (Q2-2008); Argentina, Brazil, India, Korea, Malaysia, Turkey (Q3-2008).
 Source: BIS, World Bank, IMF IFS

Government Bonds Dominate

EM Debt Securities Outstanding

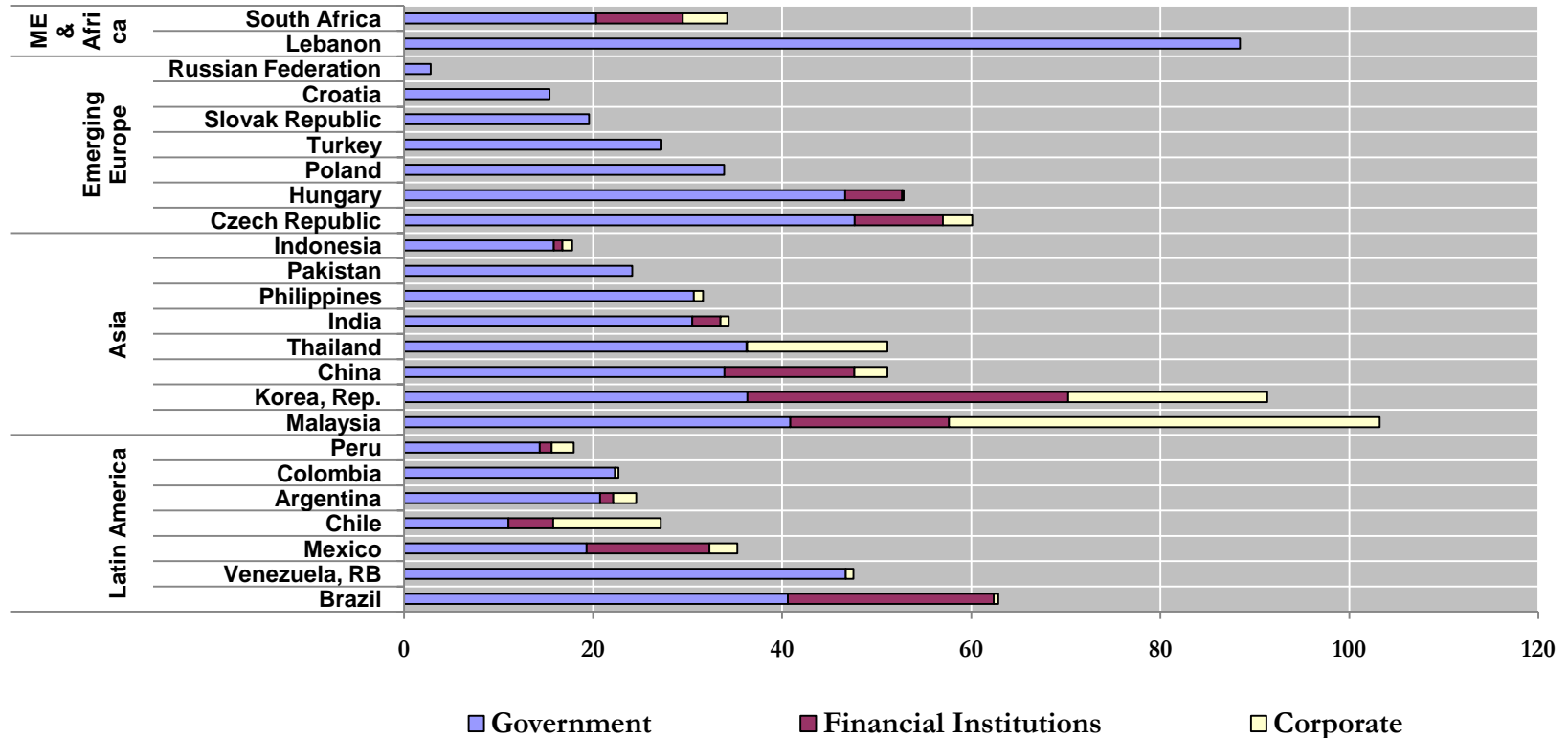


Note: 2008 data as of September.

Source: BIS

Small Non-Government Bond Markets

EM Domestic Debt Securities Outstanding
(% of GDP, 2008)

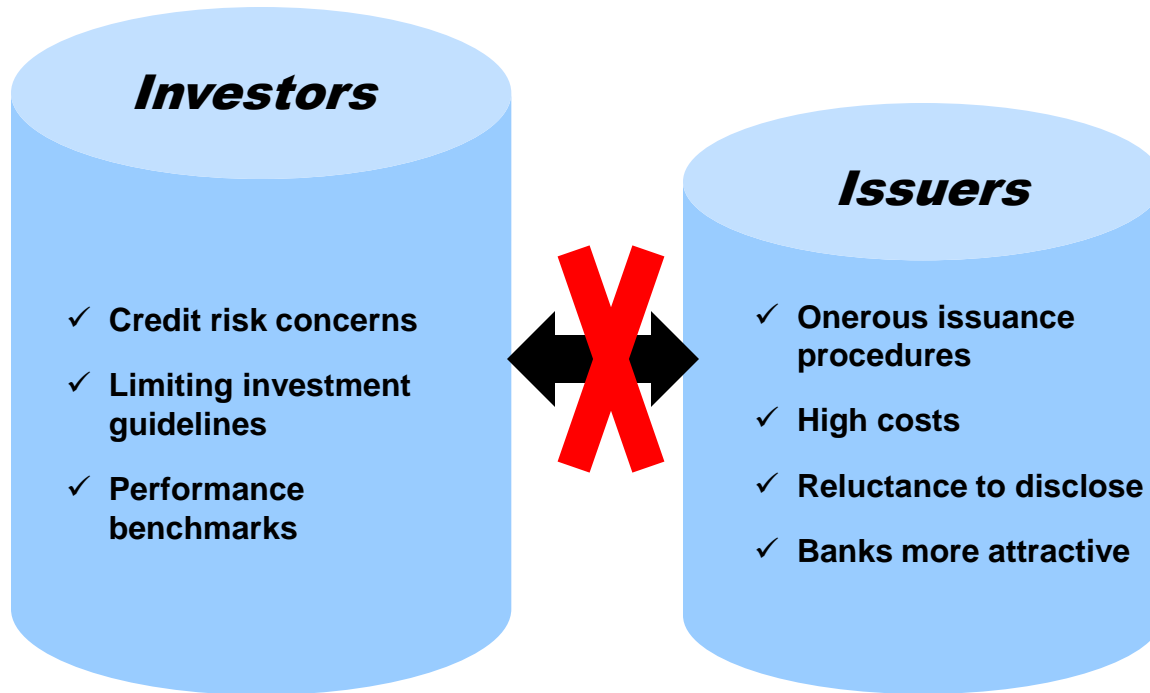


Note: GDP : Chile, Indonesia, Korea (2007). Domestic Debt Securities : End of Sep. 2008.

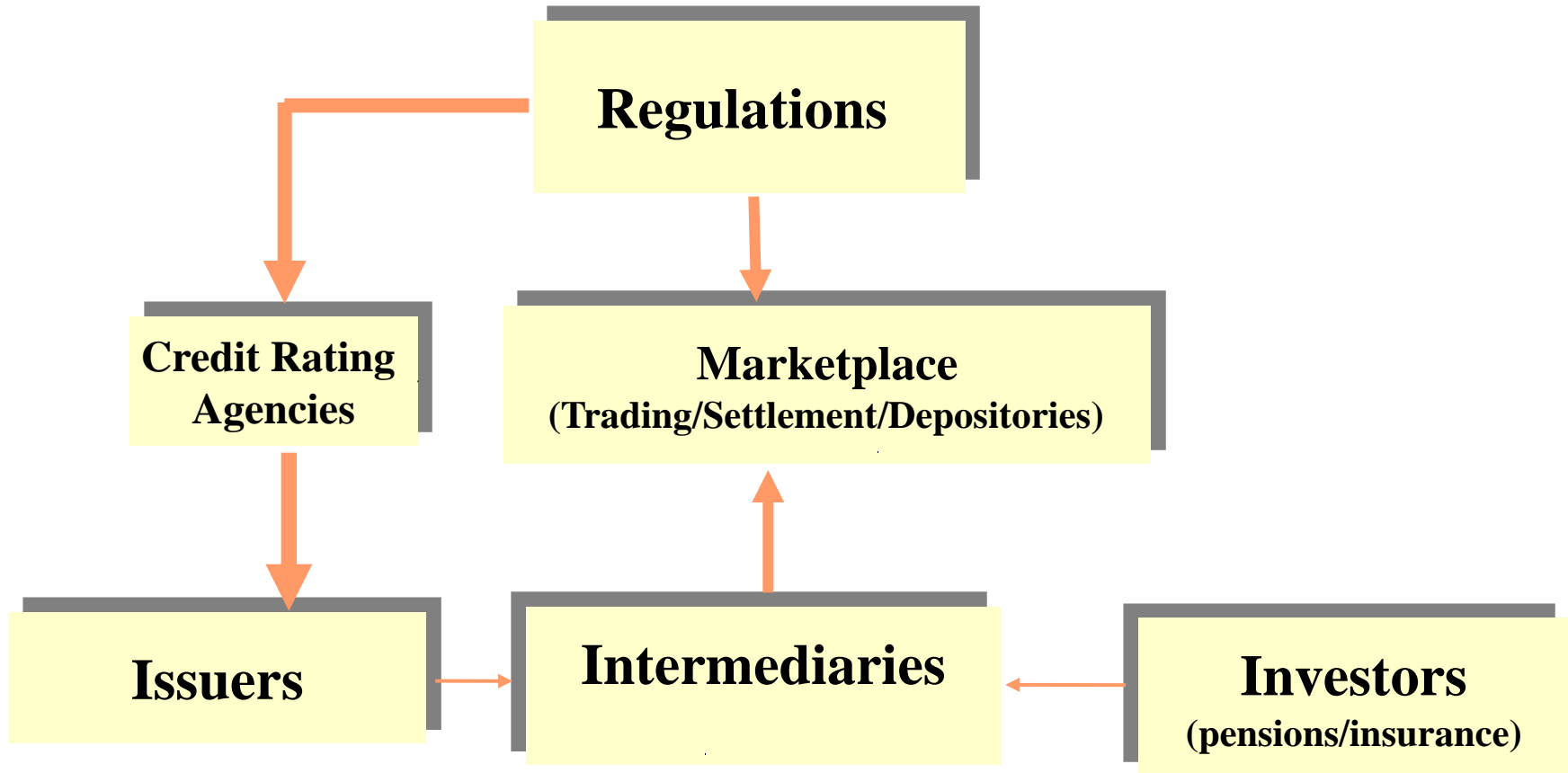
Source: BIS, World Bank WDI

Key Challenges to Bond Transactions

Transactions are obstructed by several factors



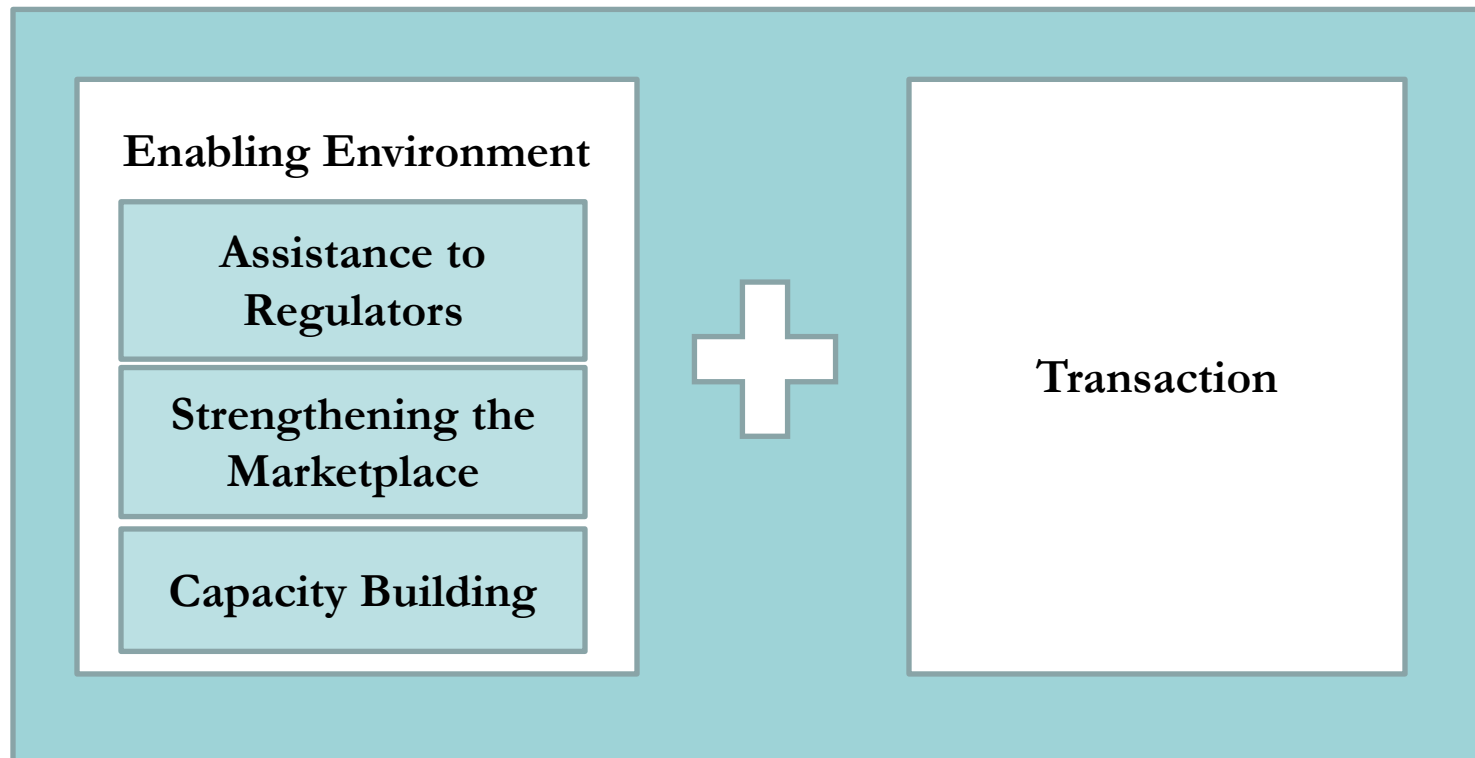
Several Market Elements Affected



Need comprehensive programs to address full range of issues

GCMSM's Programs: Comprehensive Approach

Comprehensive programs to address range of issues
Link enabling environment with transactions
Draw on full WB/IFC tools and perspectives



Unique Role of Transactions Component

Improve Enabling Environment

Regulations, market infrastructure, market participants

Technical Assistance

Transactions

Facilitate Transactions

Hands-on support to issuers/intermediaries

Knowledge of specific challenges on the ground

Yardstick for program success

ESMID-Africa (Pilot)

Comprehensive approach to developing local bond markets

- 3 year, \$5.5 million program funded by SIDA
- Transaction support as catalyst and validates success in enabling environment work
- Sub-regional program for East Africa
- Special focus on long-term funding for housing and infrastructure
- Expanding globally

Advice to Regulators on Legal and Regulatory Framework

- Improve approval process
- Reduce costs
- Framework for new products

Transactions Support

- Active support to issuers and intermediaries for replicable transactions
- Introduce new & innovative products

Strengthening Market Infrastructure

- Market Structure
- Clearing & Settlement
- Transparency & Information Dissemination

Capacity Building

- Certification/Licensing
- Training
- Develop regional provider

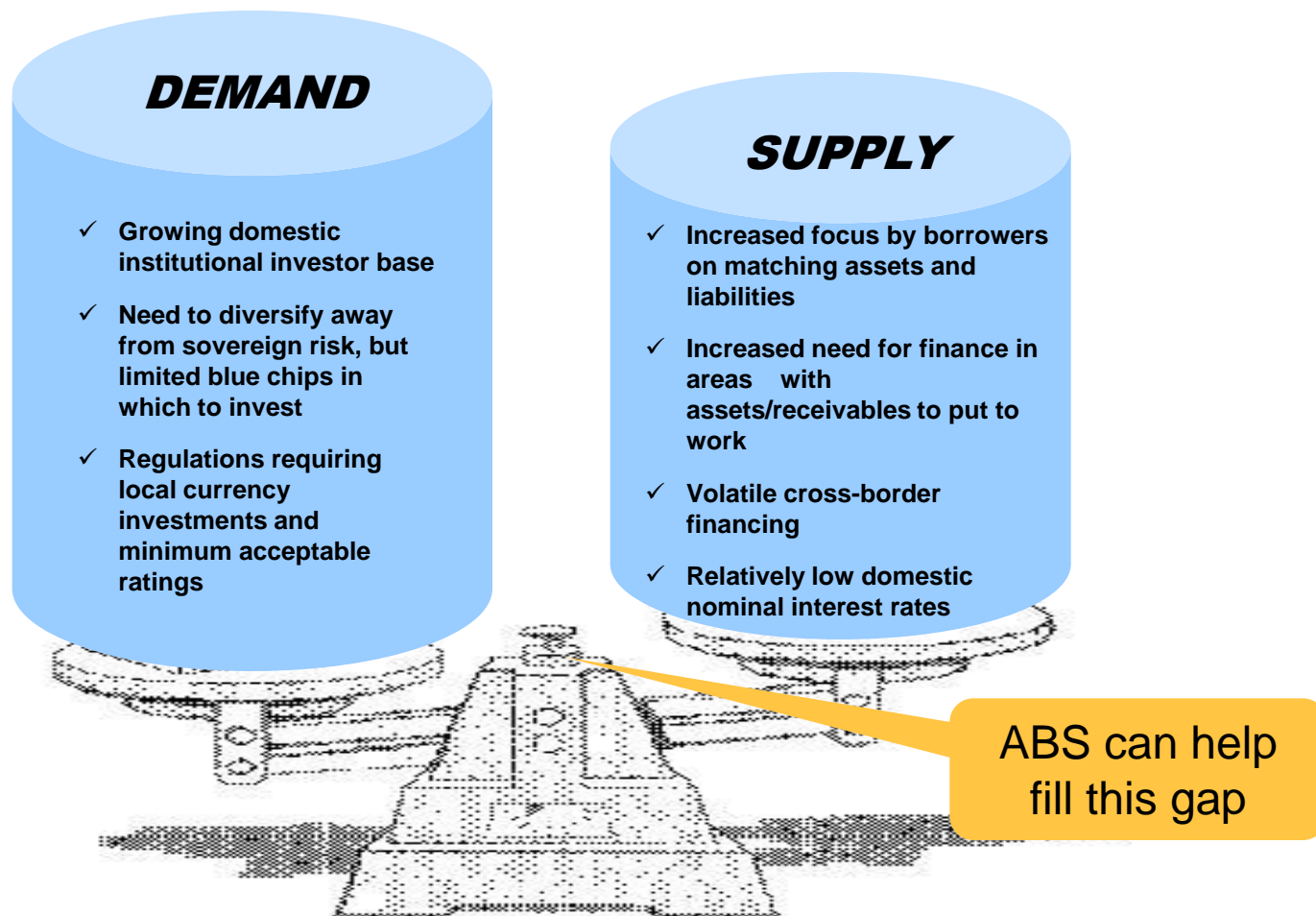
Regionalization

- Broadening & deepening markets
- Cross border issues

ESMID Africa: Pilot Program Key Achievements

- **Comprehensive assessments and implementation roadmaps**
 - Recommendations for improving legal/regulatory framework for bond issuance
 - Roadmap for flexible market model and OTC trading
 - Regional harmonization based on a mutual recognition regime and system compatibility
- **Regional training institute and licensing structure**
 - Piloted and developed regional training curriculum
 - Trained over 130 market participants and 25 local trainers
 - Assisted regulators define regional licensing framework for professionals
- **Pipeline of potential transactions**
 - Supporting promising issuers in infrastructure, housing, and microfinance sectors (Nairobi City Water & Sewage, Kenya Airport Authority, Kigali City Bus Terminal)
- **Widespread local and regional support**
 - Reached out to over 700 local actors; cultivated strong relationships with key stakeholders
 - Becoming a recognized authority on capital market development, playing a key role in policy dialogue on financial sector reforms

Importance of ABS



ABS: Fosters Bond Market Development

- **Flows of underlying assets/receivables pay off bondholders**
- **Bond credit determined by performance of underlying asset flows**
- **Helps address:**
 - **Credit concerns/provides quality assets**
 - **Small balance sheet constraints**
 - **Funding and regulatory constraints (Fis)**
- **Supports local bond market growth**
 - **More issuers can participate**
 - **More investors can participate**

Securitization at Work

The quality of the underlying assets determines the quality of the bond (ABS) issued



Possible Underlying Assets:

Infrastructure receivables (toll roads)
Mortgages, consumer, auto, other loans
Leasing receivables
Medical receivables



If Flows Are:

Reliable
Standardized
Performing

- **Increased demand for assistance**
- **Need to educate about ABS**
- **Need to advise on revised regulations**

Key issues

Underlying Loans

- Originate and distribute confused incentives
- Poor underwriting standards/weak credits
- Bad performance history
- Unregulated originators

Slicing and dicing

- Complicated structures obscured risk
- Rating agencies: difficult to assess

Investors with ST funding



- Solid credits/
regulated
originators/
performance
history
- Simple structures.
More use of
covered bonds

Regulatory Landscape: Extensive Rethinking

- **Spurred intensive rethinking of the regulatory landscape**
- **From philosophical to technical issues:**
 - Update the framework to reflect marketplace realities (who's regulated, how, by whom?)
 - Revise incentives/compensation structures (reduce risk taking, individual profits, socializing losses)
 - Question the market model
 - Revise capital and leverage calculations
- **Emerging market countries, and we, will need to wrestle with new approaches in hopes of reducing financial crises**
- **But first wait for the dust to settle**